IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF PENNSYLVANIA

CONTINENTAL CASUALTY COMPANY,	:	
	:	
Plaintiff	:	
	:	**3:CV-02-1122**
VS.	:	
	:	**(CHIEF JUDGE VANASKIE)**
RICHARD P. ADAMS, LINDA J. LEIGHTON, and JOHN SABOL,	:	
Defendants	:	
and	:	
	:	
NBT BANK, N.A.,	:	
Intervenor	:	

NBT BANK, N.A.,	:	
Plaintiff	:	
	:	
VS.	:	
	:	
CNA INSURANCE COMPANY/ CONTINENTAL CASUALTY COMPANY,	:	
Defendant	:	
	:	

ORDER

NOW, THIS 3RD DAY OF OCTOBER, 2003, having learned that there was an error in this Court's Memorandum and Order of September 12, 2003, with respect to the numbering of footnotes, **IT IS HEREBY ORDERED THAT:**

1. The Memorandum accompanying the Order of September 12, 2003 is **AMENDED** by substituting the attached Memorandum for the original Memorandum.

2. The Clerk of Court is directed to post the attached Memorandum on the Court's website.

/s/Thomas I. Vanaskie
Thomas I. Vanaskie, Chief Judge
Middle District of Pennsylvania

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	:	

M E M O R A N D U M

Pending before this Court are cross-motions for summary judgment raising the issue of whether CNA Insurance Company/Continental Insurance Company ("CNA") breached a duty to defend officers and directors of Human Services Consultants, Inc. ("HSC") in connection with negligence claims asserted against them arising out of a check kiting scheme involving an

affiliate of HSC, Human Services Consultants Management, Inc. Because it is evident that the claims against the officers and directors of CNA's insured entity, HSC, are inextricably intertwined with their conduct in the discharge of duties as directors and officers of the uninsured Human Services Consultants Management, Inc., coverage for the negligence claims asserted against them by NBT Bank, N.A. ("NBT") is explicitly excluded under the CNA policy. Accordingly, judgment will be entered in favor of CNA, and against the directors and officers of HSC as well as against NBT.

BACKGROUND

Human Services Consultants, Inc. ("HSC"), is a non-profit corporation. (NBT's Stmnt. of Undisputed Material Facts, Dkt. Entry 33, ¶ 2.)[1] New Hope of Pennsylvania, Inc., formerly known as Human Services Consultants Management, Inc. ("HSCM"), is a for-profit corporation. (Id., ¶ 3.) PA Health, Inc. ("PA Health") is also a for profit corporation. (Id., ¶ 4.) At all relevant times, Richard Adams ("Adams") and Linda Leighton ("Leighton") served as officers and directors of HSC. (Id., ¶ 5.) Adams and Leighton also served as officers and directors of HSCM and PA Health. (Id., ¶ 6.) In 1982, Adams hired John Sabol ("Sabol") to work for HSC. (Id., ¶ 7.) Sabol was initially employed in the fiscal department of HSC and was subsequently promoted to controller of HSC. (Id., ¶¶ 7-8.) From 1988 through 2000, Sabol was Chief Financial Officer of

[1]Citation to NBT's statements of material facts submitted in accordance with the Local Rules of Court signifies that the assertion has been admitted by CNA.

HSC, and from 2000 through his termination in March of 2001, he was Chief Operating Officer of HSC. (Id., ¶ 9.) Sabol also served as Chief Financial Officer of HSCM during the pertinent time frame. HSC maintained a commercial checking account at First National Community Bank of Dunmore, PA (the "First National Account"). (Id., ¶ 10.) HSCM and PA Health each maintained commercial checking accounts at NBT (the "NBT Accounts"). (Id., ¶ 11.)

In the early months of 2000, HSC was experiencing cash flow problems. (Id., ¶ 12.) At that time, Sabol undertook a check kiting scheme using the First National Account and the NBT Accounts. (Id., ¶ 13.) This practice of floating checks, or "check kiting," involved writing a check of HSCM on the NBT Accounts, depositing that check into the HSC First National Account, and then subsequently drawing on the HSC First National Account to deposit a check into the HSCM NBT Accounts. (Id., ¶ 14.) For accounting purposes, the kited checks were treated by Sabol as inter-company loans between HSC and HSCM. (Id., ¶ 15.) Neither company had sufficient funds to cover the checks that were being written to the other company under the guise of inter-company loans. (Id., ¶ 16.) Although it is disputed when Adams actually became aware of the check kiting, the scheme collapsed in March of 2001. (Id., ¶ 17.)

Initially, Sabol kited checks several times a month. (Id., ¶ 18.) Toward the end of his employment, Sabol wrote checks for which there were insufficient funds every day. (Id., ¶ 19.) Adams received monthly reports that would have captured the kited checks. (Id., ¶ 20.) Adams did not review the daily or monthly reports produced by HSC that would have reflected the kited

checks. (Id., ¶ 21.) NBT alleges that if Adams had reviewed either the daily or monthly reports, the cash balances, or the internal balance sheets of HSC, he would have realized that there was a significant problem with regard to Sabol's performance of his duties. (Id., ¶ 22.)[2] As a result of the check kiting scheme, NBT suffered actual losses in excess of $1,660,000. (Id., ¶ 33.)

Following the collapse of the scheme, NBT filed a Complaint in this Court against HSC, HSCM, PA Health, Human Services Consultants, Inc. #2, Adams, Leighton and Sabol, captioned as NBT Bank, N.A. v. New Hope of Pennsylvania, Inc., et al., No. 3:CV-01-0879 (the "Underlying Action"). (Id., ¶ 34.) In the Underlying Action, NBT advanced multiple claims, including claims against Adams and Leighton, in their capacities as officers and directors of HSC, as well as in their capacities as officers and directors of HSCM.[3] In this regard, the Amended Complaint, filed on August 20, 2001, alleged that Adams was president and sole shareholder of both HSC and HSCM, and that Leighton was Chief Operating Officer of both corporations. (Amended Complaint, ¶¶ 6-7.) The Amended Complaint further alleges that Adams and Leighton "were acting in their capacity as officers of the Corporate Defendants[4] and in their personal capacities." (Id., ¶ 10.) The Amended Complaint goes on to describe in great

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[2]Continental disputes NBT's assertion, claiming that Adams was aware of Sabol's activities.

[3]The Amended Complaint in the Underlying Action is attached as Exhibit "A" to the Brief in Support of CNA's Summary Judgment Motion, Dkt. Entry 36.

[4]Both HSC and HSCM were corporate defendants.

detail the check kiting scheme. The Amended Complaint specifically avers that the scheme was perpetrated by checks deposited in and drawn on an account held by HSC at First National Bank of Dunmore and checks deposited in and drawn on the account held by HSCM at NBT. (Id., ¶ 29.) Paragraph 45 of the Amended Complaint avers that "[a]ll acts of Defendants in connection with the check kiting scheme were done with the participation of defendants Adams and Leighton, at the direction of Defendants Adams and Leighton, with the assent of Defendants Adams and Leighton, and/or with the cooperation of Defendants Adams and Leighton." The Amended Complaint further asserts that Adams, "in his capacity as sole shareholder and President, Treasurer and Secretary of the Corporate Defendants," used the corporate entities to perpetrate the check kiting scheme and to further his personal interests. (Id., ¶ 52.)

Included among the 15 separate counts set forth in the Amended Complaint is a claim of negligent hiring and supervision against, inter alia, HSCM, HSC, Adams, and Leighton. (Amended Complaint, Count VII.) The gist of this count is that the defendants had failed to exercise ordinary care in supervising Sabol "as Chief Financial Officer and/or Chief Operating Officer" of, inter alia, HSC and HSCM. (Id., ¶ 121.) The averments of Count VII do not distinguish between negligent conduct on the part of Adams and Leighton with respect to each of the corporate entities. Instead, the Amended Complaint merely alleges negligence in supervision generally. Count X of the Amended Complaint alleges negligent misrepresentation against all defendants, and does not distinguish between conduct committed on behalf of HSC

as opposed to conduct committed on behalf of HSCM.

HSC was insured by CNA under a Health Care Executive Liability Insurance Policy (the "Policy"). (NBT's Stmnt. of Undisputed Material Facts, Dkt. Entry 33, ¶ 36.) Adams, Leighton and Sabol were classified as "individual insureds" under the Policy in connection with their actions on behalf of HSC only. In this regard, the Policy defined "individual insureds" to include directors and officers of HSC.[5] An amendment to the Policy specifically excluded any claim made against "policy insureds" by or on behalf of HSCM.

Upon institution of the Underlying Action, HSC, Adams, and Leighton each made claims under the Policy, seeking a defense to the Underlying Action. (Id., ¶ 43.) Initially, CNA provided a defense to HSC, Adams, and Leighton under the Policy. (Id., ¶ 44.) However, by letter dated October 25, 2001, CNA withdrew its defense of Adams and Leighton. (Id., ¶ 45.)[6] CNA's denial of coverage is based on Exclusion L of the Policy, which reads:

> The insurer shall not be liable to pay any loss in connection with any claim: based upon, arising out of, directly or indirectly resulting from, in consequence of, or in any way involving any actual or alleged conduct by the individual insureds in the discharge of their duties as directors, officers, trustees, employees or volunteers of any entity other than the [insured] Entity or [insured] Charitable Organization, even if directed or requested by the [insured] Entity to serve as

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[5]A copy of the pertinent policy is found at Exhibit "B" to the Brief in Support of CNA's summary judgment motion. The definition in question appears under that part of the Policy captioned "Health Care Executive Liability Insurance Policy – Organization Liability Coverage Part With Duty to Defend."

[6]CNA continued to defend HSC in the Prior Action. (Id., ¶ 46.)

directors, officers, trustees, employees or volunteers of such entity.

(Id., ¶ 47.) The denial of coverage letter asserted:

> There is no longer any question that the named Individual Insureds, Richard P. Adams, Linda Leighton and John Sabol, acted in the discharge of their duties as directors and/or officers for HSCM (a separate entity and not an Insured under the Policy), when they opened and maintained the HSCM account . . . into which the kited checks were deposited, thereby giving rise to the instant Claim. As such, Exclusion L applies to bar further coverage.

Ex. "D" to NBT's Stmnt. of Undisputed Facts.

Adams and Leighton thereafter retained separate counsel, and the prior action progressed. (Id., ¶ 48.) Adams and Leighton subsequently reached a settlement agreement with NBT in the prior action. (Id., ¶ 49.) The terms of the Settlement Agreement included (1) payment of $50,000; (2) judgment against Adams in the amount of $1,200,000 in his capacity as an officer and director of HSC on Counts VII (Negligent Hiring and Supervision) and X (Negligent Misrepresentation); and (3) the assignment by Adams and Leighton of any and all claims each has or may have against CNA arising from or under the Policy, in exchange for an agreement by NBT not to execute, record or collect on the judgment against Adams in his capacity as an officer and director of HSC. (Id., ¶ 50.)

On June 12, 2002, NBT, as assignee of the rights of Adams and Leighton, instituted an action in the Lackawanna County Court of Common Pleas, alleging that CNA breached its duty to defend Adams and Leighton, breached its duty to indemnify Adams, and acted in bad faith in

denying coverage under the Policy. On June 28, 2002, CNA instituted a declaratory judgment action in this Court (docket number 3:CV-02-1122) seeking a declaration that it had neither a duty to defend nor a duty to indemnify Adams, Leighton and Sabol in the Underlying Action. On July 26, 2002, CNA removed the NBT action to this Court, where it was assigned docket number 3:CV-02-1290.[7] On August 27, 2002, this Court consolidated the two cases under docket number 3:CV-02-1122. (Id.)

Presently before the Court are cross-motions for summary judgment on the duty to defend issue. Oral argument was conducted on June 26, 2003, and post-argument briefs were filed. The material facts are not disputed and the matter is ripe for disposition.

DISCUSSION

Under Pennsylvania law,[8] "[t]he construction of an insurance policy is a question of law which must be resolved by the courts." Hunyady v. Aetna Life & Cas., 396 Pa. Super. 476, 478, 578 A.2d 1312, 1313 (1990), aff'd, 530 Pa. 25, 606 A.2d 897 (1992)(citing Loomer v. M.R.T. Flying Service Inc., 384 Pa. Super. 244, 246, 558 A.2d 103, 105 (1989)). When interpreting the insurance contract, "the goal of [the] task is, of course, to ascertain the intent of the parties as manifested by the language of the written instrument." Niagara Fire Ins. Co. v. Pepicelli,

[7]CNA filed a motion to dismiss the action brought by NBT. In light of the determination that CNA was not obligated to defend Adams, Leighton or Sabol, the motion to dismiss appears to be moot.

[8]Pennsylvania law governs the interpretation of the insurance policy at issue here. Northbrook Ins. Co. v. Kuljian Corp., 690 F. 2d 368, 371 (3d Cir. 1982).

Pepicelli, Watts & Youngs, P.C., 821 F.2d 216, 220 (3d Cir. 1987)(citing Mohn v. American Cas. Co. of Reading, 458 Pa. 576, 326 A.2d 346 (1974)). Additionally, "[w]here a provision of a policy is ambiguous, the policy provision is to be construed in favor of the insured and against the insurer, the drafter of the agreement." Id. If the language is clear and unambiguous, however, a court is required to give effect to that language. Pennsylvania Mfrs'. Ass'n Ins. Co. v. Aetna Ca. & Sur. Ins. Co., 426 Pa. 453, 457, 233 A.2d 548, 551 (1967). In determining whether a provision in an insurance policy is ambiguous, the test is whether "reasonably intelligent persons on considering it in the context of the entire policy would honestly differ as to its meaning." Celley v. Mutual Benefit Health & Accident Ass'n, 229 Pa. Super. 475, 481-482, 324 A.2d 430, 434 (1974). Thus, "[t]he fact that the parties do not agree upon the proper interpretation does not necessarily render the contract ambiguous." Vogel v. Berkley, 354 Pa. Super. 291, 297, 511 A.2d 878, 881 (1986). Additionally, in St. Paul Fire & Marine Ins. Co. v. U.S. Fire Ins. Co., 655 F.2d 521, 524 (3d Cir. 1981), the court stated that "[a] court should read policy provisions to avoid ambiguities, if possible, and not torture the language to create them." As a result, "the Court [should] adopt the interpretation which, under all the circumstances of the case, ascribes the most reasonable, probable and natural intention of the parties, bearing in mind the objects manifestly to be accomplished." Galvin v. Occidental Life Ins. Co. of Cal., 206 Pa. Super. 61, 65, 211 A.2d 120, 122 (1965).

The issue in the present case is whether CNA had a duty to defend and/or indemnify

Adams and Leighton in the Underlying Action.[9] An insurer's duty to provide a defense for the insured is broader than an insurer's duty to indemnify the insured. See J.H. France Refractories Co. v. Allstate Ins. Co., 534 Pa. 29, 43, 626 A.2d 502, 510 (1993); Lebanon Coach Co. v. Carolina Cas. Ins. Co., 450 Pa. Super. 1, 14, 675 A.2d 279, 286 (1996) ("An insurer's duty to defend is a distinct obligation, different from and broader than its duty to provide coverage."), app. denied, 546 Pa. 695, 687 A.2d 378 (1997). An insurer's duty to defend is determined by the complaint giving rise to the claim against the insured; any claims which arguably could fall within a policy's coverage must be defended. See Erie Ins. Exch. V. Transamerica Ins. Co., 516 Pa. 574, 583, 533 A.2d 1363, 1368 (1987).

There is no question that Adams and Leighton are named insureds under the Policy and that NBT's negligence claims against them fall within the Policy's coverage. The penultimate question presented here is whether Exclusion L, as amended by the Policy endorsement concerning "Outside Directorship - - Charitable Organizations," relieves CNA of the duty to defend Adams and Leighton, particularly with respect to the negligence claims asserted in Counts VII and X of the Amended Complaint filed in the Prior Action. CNA claims that the check kiting scheme necessarily involved actions on the part of both HSC and HSCM such that negligence claims against Adams and Leighton as officers and directors of HSC are inextricably

[9]There appears to be no real dispute that CNA did not have a duty to defend Sabol. In any event, the conclusion that there exists no duty to defend Adams and Leighton necessarily extends to Sabol.

connected to the discharge of their duties as officers and directors of HSCM.

On the other hand, NBT, at page 9 of its supporting brief (Dkt. Entry 34), argues:

> It is simply beyond dispute that the claims in the Prior Action fell within the coverage provisions of the Policy. Adams and Leighton were "Individual Insureds" against whom NBT made claims for Wrongful Acts in the Prior Action that fell within the scope of coverage under the Policy (i.e. negligence). Specifically, the Prior Action alleged that Adams and Leighton were negligent in their capacity as officers and directors of HSC, and that such negligence was the cause of the damages suffered by NBT as a result of Sabol's scheme.[10]

In support of its position, NBT primarily relies on Bowie v. The Home Ins. Co., 923 F.2d 705 (9th Cir. 1991). In Bowie, the Plaintiffs, Bowie and Gregory, were former officers and directors of Transit Casualty Company ("Transit"). They were also directors of DMT Financial Group ("DMT"). DMT, its officers and directors were insured under an errors and omissions policy (the "policy") issued by The Home Insurance Company ("the insurer"). After the collapse of a risk management plan involving Bowie and Gregory in their capacities as officers and directors of Transit and DMT, both individuals were named as defendants in a California suit to recover damages. Bowie and Gregory, however, were named as defendants only in their capacities as former officers and directors of Transit, the uninsured entity. They were not named in their capacities as officials of DMT. Id. at 706.

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[10]It bears noting that the Amended Complaint did not allege that Adams and Leighton were negligent solely in their capacities as officers and directors of HSC. Instead, the Amended Complaint averred that they were negligent officers and directors of all pertinent entities.

Bowie and Gregory sought defense and indemnification from the insurer, seeking coverage under the DMT policy. After the insurer denied coverage, Bowie and Gregory filed a declaratory judgment action. The district court dismissed the suit, finding Bowie and Gregory not insureds in their capacities as Transit directors. The dismissal, however, was without prejudice to the filing of a new suit in the event that they were named as defendants in their role as DMT directors and the insurers persisted in refusing to defend. Id.

On appeal, Bowie and Gregory contended that, in dismissing their action for failure to state a claim, the district court erred in concluding that they were not insureds under the DMT policy. Id. at 706-07. The policy in Bowie provided:

> The unqualified word "insured" whenever used means:
> 1) The named Insured herein defined as the individual, partnership, or corporation designated as such in the Declarations.
> 2) *any* partner, officer, *director*, stockholder or employee *while acting within the scope of their duties as such . . . .*

Id. at 707. Bowie and Gregory claimed coverage because, while sued only in their capacity as officers and directors of Transit, the underlying claims implicated actions they took on behalf of the insured entity, DMT, and the complaint could be amended to sue them for conduct undertaken on behalf of DMT. The court declined to accept this argument, explaining:

> In this diversity suit we are bound by the principles of *Gray* [v. Zurich Ins. Co., 65 Cal.2d 263, 275, 54 Cal.Rptr. 104, 112, 419 P.2d 168, 176 (1966)], but we cannot agree with the attempted extension of these principles, as urged by Bowie and Gregory. They rely on *dicta* in *Gray* to the effect that the insurer was alternatively liable because, although the complaint sought relief only on the basis of uninsured conduct, it was subject to amendment to add insured (negligent) conduct. *Gray*,

> 65 Cal.2d at 277, 54 Cal. Rptr. at 113, 419 P.2d at 177. Thus, they imply that, even though the complaint in the California action does not name any parties in their insured capacities, it could be amended to do so.
>
> The phrase "duty to defend" presupposes the existence of a lawsuit against an "insured," requiring a defense under the policy. Here, that supposition simply does not apply. The insurers have not unqualifiedly covered Bowie and Gregory, but rather only have secured them in their capacities as DMT officials. The California action names them as defendants only in their capacities as Transit officials. The mere fact that Bowie and Gregory are named in the California action is not controlling. The directors of Transit and the directors of DMT may as well have been completely different people. What is important is not their identities but their capacities. Here the insured capacities are not implicated in the California action. Because there is no lawsuit against an insured party, there is no one to whom a duty to defend is owed.
>
> * * *
>
> While the courts have found a "potential for liability" (for purposes of the duty to defend) where a complaint could be theoretically amended to allege, against an insured already named as a defendant in the suit, claims covered under the policy, no California court has extended that rule to one not sued in an insured capacity. In other words, no court has said that an insurer must defend an insured *not yet named* in an insured capacity as a defendant in a suit, even though a complaint could be so amended.

Id. at 708,709. The Ninth Circuit concluded:

> Bowie and Gregory have not been named in the California action as officials of DMT. The Bowie and Gregory who are DMT officials have nothing to do with the Bowie and Gregory named (as Transit directors) in that action. Nonetheless, they attempt to parlay their dual capacities into a free defense of claims for astronomical damages against officials of a company not insured by their insurers. California law neither requires such a result, nor permits it.

Id. at 709.

> Bowie is not applicable here, where Adams and Leighton have been sued in their

capacities as officers and directors of both an insured and uninsured entity. NBT relies on a footnote in Bowie, which stated that "[t]here would, of course, be a duty to defend if Bowie and Gregory were sued in their capacities as officials of DMT." Id. at 709 n.4. NBT argues that "the Bowie Court unequivocally interpreted its policy exclusion precisely as NBT does here: a duty to defend exists any time an insured is sued in their capacity as an officer or director of the insured entity (here HSC, there DMT), even if they are also sued in a separate capacity as an officer or director of another, uninsured entity (here HSCM, there Transit), for different wrongful acts." (NBT Supp. Brief at 13.)

NBT stretches the Bowie dicta too far. The Bowie court never addressed the applicability of the policy exclusion in that case because it was not required to do so. As CNA points out, "because the Bowie Court found that the officers were not insureds in the first instance, it never reached the issue of whether the exclusion would apply." (CNA Supp. Brief at 6.) Furthermore, Bowie did not involve an exclusion worded as broadly as CNA's Exclusion L.

Exclusion L provides that CNA "shall not be liable to pay any loss in connection with any claim based upon, arising out of, directly or indirectly resulting from, in consequence of, or in any way involving any actual or alleged conduct by the individual insureds in the discharge of their duties as directors, officers, trustees, employees or volunteers of any entity other than the entity or charitable organization, even if directed or requested by the entity to serve as directors, officers, employees or volunteers of such entities." (Emphasis added.) The check kiting

scheme could only be effectuated by actions taken by individual insureds in the discharge of their duties as directors and officers of both the insured entity, HSC, and the uninsured entity, HSCM. As CNA observes, a checking account in the name of HSCM in a bank other than the financial institution at which HSC maintained its demand deposit account was required. Moreover, the Amended Complaint alleges actions taken by Adams and Leighton in their capacities as officers and directors of HSCM to facilitate the scheme. (See Amended Complaint, ¶¶51-54.) The claims of negligence against Adams and Leighton in their capacities as officers and directors of HSC, at a minimum, "indirectly result from," are "in consequence of," or "in some way involved" conduct of Adams and Leighton in the discharge of their duties as directors and officers of HSCM. Adams and Leighton owed the same duty to supervise Sabol as an officer of HSCM as they did with respect to his status as an officer of HSC. Adams and Leighton could have discovered the check kiting scheme in their capacities as officers and directors of HSCM, just as it is alleged that they should have discovered it when wearing their HSC hats. The point is that they wore the hats of both companies at the same time.

NBT asserts that Counts VII and X of the Amended Complaint include claims based solely upon the negligence of Adams and Leighton in their capacity as officers and directors of HSC. This assertion is inaccurate, as the Amended Complaint does not distinguish among the roles played by Adams and Leighton in the corporate defendants. Moreover, NBT's argument ignores the fact that coverage is excluded where the claim is not only based upon conduct

undertaken on behalf of an insured entity, but also "results indirectly from," "in consequence of," or "in any way involves" conduct by the individual insureds in discharge of their duties as directors and officers of an uninsured entity. The policy provision could hardly be more clear in excluding coverage to officers and directors participating in a check kiting scheme involving both an insured and an uninsured entity. Indeed, to hold otherwise would give officers and directors of closely held entities a "blank check" to engage in check kiting while having an insurance company ultimately holding the bag.

The parties have not cited, and research has failed to disclose, any case applying an exclusion as broadly worded as "Exclusion L." The Third Circuit's consideration of a more limited exclusion in professional liability policies issued to attorneys, and the application of the Third Circuit's analysis of the professional liability exclusion by District Courts in the Third Circuit, however, confirm that coverage in this case is indeed excluded.

In Niagra Fire Ins. Co. v. Pepicelli, Pepicelli, Watts & Youngs, P.C., 821 F.2d 216 (3d Cir. 1987), the court assessed the scope of "other business" exclusions analogous to the exclusion at issue here. Attorney Pepicelli was both a lawyer and business person. A company he owned, World of Tires, agreed to purchase a tire recapping plant from Perma Tread, and obtained a fire insurance policy on the plant. A fire destroyed the plant before World of Tires completed its payments. Pepicelli's law firm undertook to represent World Tires, as well as Perma Tread, in pursuing a claim on the fire insurance policy. Perma Tread subsequently sued

Pepicelli's law firm for negligence in handling the fire loss claim. The malpractice insurer for the law firm refused coverage on the basis of exclusions for "any claim arising out of any insured's activities as an officer or director of any . . . company or business other than that of the Named Insured," and "any claim made by or against or in connection with any business enterprise . . . not named in the Declarations, which is owned by any insured . . . ." Id. at 218. Applying principles of interpretation of insurance contracts established by Pennsylvania law, our Court of Appeals concluded that the malpractice claim did not fall within the scope of the exclusions. Writing for the unanimous panel, Judge Stapleton explained:

> The exclusions speak of excluded claims, and thus the character of the specific legal claims, rather than the malpractice suit's general factual background, must be analyzed to determine the exclusion at issue. The claims made by Perma Tread deal only with negligence and breach of contract in the Law Firm's representation of Perma Tread, and resolution of the claims will affect only the interests of Perma Tread and the Law Firm. Neither the actions nor the interests of Pepicelli in his business venture, World of Tires, are at issue in the malpractice suit.. . .
>
> Perma Tread's malpractice claims do not "aris[e] out of any insured's activities as an officer or director of any . . . corporation . . . other than that of the Named Insured." As Niagara explains in its brief, an attorney may simultaneously act as a lawyer and as an officer or a director of a business, and [the other business] exclusion is designed to prevent coverage for a claim based upon such actions. Although Pepicelli is an officer and director of World of Tires, Perma Tread's malpractice suit is based solely on Pepicelli's and the Law Firm's legal representation. The allegedly negligent legal representation did not simultaneously involve business decisions by Pepicelli.

Id. at 220-21 (emphasis added).

Unlike the factual matrix presented in Pepicelli, the allegations of the Amended Complaint

in the Underlying Action plainly show Adams and Leighton acting simultaneously in dual capacities: as officers and directors of both the insured and the uninsured corporations. Their alleged negligent supervision of Sabol applies both in their capacities as officers and directors of HSC, as well as in their capacities as officers and directors of HSCM. Indeed, the Amended Complaint does not purport to distinguish between actions taken on behalf of one corporation and actions taken on behalf of the other. Moreover, while World of Tires was merely "a player in the factual background" of the Pepicelli decision, HSCM is an integral actor in the check kiting scheme. While World of Tires had no interest in the litigation underlying the malpractice claim in Pepicelli, HSCM had a vital interest in the Underlying Action. While Perma Tread's malpractice claims did not "'aris[e] out of any insured's activities as an officer or director of any corporation . . . other than that of the Named Insured," NBT's negligence claims plainly have the requisite nexus to the activities of Adams and Leighton on behalf of HSCM to fall within the scope of Exclusion L. Indeed, under NBT's own theory, had Adams and Leighton not been negligent in supervising Sabol as an officer of HSCM, NBT would not have sustained substantial losses.

The Pepicelli analysis has been applied to sustain an insurer's denial of coverage where a named insured acted simultaneously on behalf of the interests of an insured and uninsured entity. For example, in Coregis Ins. Co. v. LaRocca, 80 F. Supp. 2d 452 (E.D. Pa. 1999), Attorney LaRocca had been sued for his role in a failed real estate investment scheme. It was claimed that LaRocca was negligent in his conduct as an attorney as well as in his capacity as a

partner and trustee of the New Gretna Realty Trust. LaRocca sought coverage for the legal malpractice claims from his malpractice insurer, Coregis Insurance Company. Id. at 453. Coregis disclaimed coverage on the basis of exclusions for "any CLAIM arising out of an INSURED's activities as an officer . . . of any company . . . other than the NAMED INSURED," as well as for "any CLAIM arising out of or in connection with the conduct of any business enterprise other than the NAMED INSURED . . . which is owned by an INSURED or in which any INSURED is a partner . . . ." Id. at 454. After finding that the underlying legal malpractice claims fell within the coverage of the Coregis policy and that the pertinent exclusions were expressed in clear and unambiguous language, the court applied the Pepicelli analysis to determine whether the malpractice claims were excluded from coverage. After finding that, unlike Pepicelli, the named insured's interests in his business (New Gretna) were at issue in the underlying litigation, the court concluded that Attorney LaRocca's legal representation was so closely intertwined with his role as a partner and trustee in New Gretna that coverage of the malpractice claim was excluded. The court explained:

> The allegations [in the underlying action] involve overlap between LaRocca's role as legal counsel and partner/trustee to New Gretna, because his knowledge of [wrongful] conduct and supervision of transactions could have arisen from or related to both roles. Thus, the underlying legal malpractice claims 'simultaneously involve[d] business decisions by [LaRocca],' which is the precise scenario under which the Court of Appeals for the Third Circuit suggested that such an exclusion would apply.

Id. at 457. Rejecting an argument similar to that advanced by NBT here – that the claims of

negligence could be isolated and segregated such that the claims against a named insured for actions taken on behalf of the named insured were not excluded from coverage, the court stated:

> The underlying legal malpractice claims . . . focus on events that took place during a time when LaRocca wore two hats: one as legal counsel to New Gretna, and another as trustee and part owner of New Gretna. Distinguishing with certainty between the roles LaRocca was playing at different moments in his dealings with New Gretna . . . could prove impossible. The broad, inclusive language of the exclusions, however, makes the drawing of such distinctions unnecessary. The exclusions apply to any claims that 'arise out of' situations in which the insured was both a lawyer to a business and an officer in that same business, and because LaRocca played both roles in New Gretna and the malpractice claims arise out of those roles, the exclusions apply to the suits against him.

Id. at 459.

The LaRocca court cited with approval Coregis Ins. Co. v. Bartos, Broughal & DeVito, LLP, 37 F. Supp. 2d 391 (E.D. Pa. 1999). That case also involved legal malpractice claims brought against an attorney who functioned both as a lawyer and as a promoter of an investment scheme. In finding that the malpractice claims were excluded under the same policy language at issue in LaRocca, the court held that the malpractice claims plainly arose out of, or were in connection with, a business entity other than the named insured which was owned by a named insured. Id. at 394. The court further ruled that the malpractice claims could not be segregated where the conduct of the named insured "forms part of an 'ongoing scheme of deception and misappropriations' . . . ." Id. at 394 n. 4.

The message of Pepicelli, LaRocca, and Bartos is that an otherwise covered claim of negligence of a named insured is excluded where that claim is closely connected to the named insured's activities as an agent of an entity other than the named insured. In this case, the language of Exclusion L is more capacious than that at issue in Pepicelli and its progeny. The averments of the Amended Complaint in the Prior Action make clear that Adams and Leighton simultaneously acted as officers and directors of HSC and HSCM. The claims against them in their capacities as officers and directors of HSC are inextricably intertwined with their actions on behalf of HSCM. Were the entities in this case separate and distinct, without overlapping officers and directors, there undoubtedly would be cross-claims, with HSCM claiming the losses were caused by the officers and directors of HSC, and HSC making the same assertion against HSCM officers and directors. An endorsement to the Policy excludes claims made against any policy insured by or on behalf of HSCM. This exclusion is consistent with the intent expressed in Exclusion L, which is to avoid coverage where a claim against a named insured in any way involves actual or alleged conduct of individual insureds as agents of an uninsured entity. Under the analysis employed in Pepicelli, LaRocca and Bartos, coverage in this case is plainly excluded.[11]

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[11]The two cases cited in NBT's post-argument brief for the proposition that the Pepicelli analysis compels a finding of coverage here are plainly distinguishable. In Smith Kandal Real Estate v. Continental Casualty Co., 67 Cal. App. 4th 406, 79 Cal. Rptr. 2d 52 (1998), the court addressed an exclusion for "'any claim arising from the . . . sale of property, developed,

(continued...)

III. CONCLUSION

For the reasons set forth above, NBT's Motion for Partial Summary Judgment (Dkt. Entry 32) will be denied, and CNA's Motion for Summary Judgment (Dkt. Entry 35) will be granted. An appropriate Order follows.

s/ Thomas I. Vanaskie

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[11](...continued)
constructed or owned by . . . you or . . . any entity in which you have a financial interest.'" Id. at 410-11. This exclusion is much narrower than that at issue here. The underlying claim in Smith Kandal concerned alleged negligence in acting as a broker for a purchaser and the structuring of the transaction to effect a tax-deferred exchange. The court found that the claim did not fall within the policy exclusion because, although Smith Kandal had an ownership interest in the property sold, its alleged negligence concerned the structuring of the transaction for tax purposes. The court further reasoned that the exclusion was inapplicable because the plaintiffs in the underlying action "could recover against Smith Kandal by proving that the acts performed on the [plaintiffs'] behalf were negligent without proof that negligent conduct was also designed or intended to benefit or be on behalf of [the uninsured entity]." Here, by way of contrast, NBT could not recover without showing that the alleged negligence of Adams and Leighton benefitted the uninsured entity.

The other case cited by NBT, Fireman's Fund Ins. Co. v. Puget Sound Escrow Closers, Inc., 96 Wash. App. 227, 979 P.2d 872 (1999), is also distinguishable because the policy exclusion was more limited than that presented here, covering only claims "arising out of or connected with the performance or failure to perform services for any person or organization . . . owned or controlled by any Insured . . . ." Id. at 237, 979 P.2d at 877-78. Moreover, the claim of negligence was limited to the failure to remove senior liens on the title to certain property, action that would be required by the named insured as the escrow agent for the plaintiffs in the underlying action. This claim did not implicate the named insured's actions on behalf of the uninsured entity. Furthermore, unlike the Prior Action in this case, there is no indication that the underlying litigation in the Washington case involved the uninsured entity.

Thomas I. Vanaskie, Chief Judge
Middle District of Pennsylvania

DATED: September 12, 2003

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IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF PENNSYLVANIA

CONTINENTAL CASUALTY COMPANY,	:	
	:	
Plaintiff	:	
	:	**3:CV-02-1122**
VS.	:	
	:	**(CHIEF JUDGE VANASKIE)**
RICHARD P. ADAMS, LINDA J. LEIGHTON, and JOHN SABOL,	:	
Defendants	:	
and	:	
	:	
NBT BANK, N.A.,	:	
Intervenor	:	

NBT BANK, N.A.,	:	
Plaintiff	:	
	:	
VS.	:	
	:	
CNA INSURANCE COMPANY/ CONTINENTAL CASUALTY COMPANY,	:	
Defendant	:	
	:	

O R D E R

NOW, THIS 12th DAY OF SEPTEMBER, 2003, IT IS HEREBY ORDERED THAT:

1. The motion by NBT Bank, N.A. for partial summary judgment (Dkt. Entry 32) is **DENIED**.

2. The motion by CNA Insurance Company/Continental Casualty Company (Dkt. Entry 35) is **GRANTED**.

3. The motion to dismiss filed on behalf of CNA Insurance Company/Continental Casualty Company in connection with the litigation initiated by NBT and removed to this Court (Dkt. Entry 19) is **DISMISSED AS MOOT**.

IT IS FURTHER ORDERED AND DECREED THAT CNA Insurance Company/Continental Casualty Company has no duty to defend or indemnify Richard Adams, Linda Leighton or John Sabol in the underlying action captioned as NBT Bank, N.A. v. New Hope of Pennsylvania, et al., and docketed in this Court to No. 3:CV-01-879.

IT IS FURTHER ORDERED THAT the Clerk of Court shall mark this consolidated action **CLOSED**.

s/ Thomas I. Vanaskie
Thomas I. Vanaskie, Chief Judge
Middle District of Pennsylvania